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**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION**

# Pipeline Safety Fee Analysis

Summary of Project Results and  
Recommendations

# Washington Utilities and Transportation Commission

## *Executive Summary of Project*

### **Introduction**

We are pleased to present this summary of project results and recommendations. Washington Utilities and Transportation Commission (the WUTC) engaged Miller & Miller, P.S. to conduct this project. The project addressed WUTC's costs and fees related to the Pipeline Safety program.

The WUTC is interested in receiving advice and consultation regarding fee-setting methodologies that could be applied in the Pipeline Safety program. This project is also designed to provide advice and consultation in establishing a regulatory incentive program and a Federal indirect cost rate for the WUTC as a whole. Information regarding the regulatory incentive program and a Federal indirect cost rate has been provided to the WUTC separately and is not included in this report.

### **Key Considerations**

The WUTC manages the Pipeline Safety Program for entities operating within Washington State. In establishing the regulatory programs, the Washington State Legislature required that all companies subject to these regulations pay the full cost of operating the program in an equitable manner. In our consideration of equity and fairness, the following were the key concepts, which guided our work:

- The fees should closely approximate the amount of effort caused by individual companies. As such, to the extent that costs and time can be directly associated with a company activity, they should be so designated.
- Costs that are not directly linked to individual company effort should be distributed to all companies on a uniform and easily understood method.
- The Federal awards are provided to support two types of pipeline safety programs: Gas Transmission and Hazardous Liquid. These are significant funding sources to the programs. The methodology should maintain the integrity of the purpose of the Federal funding.
- Companies should not be subject to large fluctuations in fees from year to year unless a significant event compels otherwise. Similarly, companies should be protected from extraordinary increases due to changes from one methodology to another.

## Recommendations

No methodology is perfect, but varying degrees of reasonableness can be assessed depending upon the criteria by which reasonableness is judged. We believe the current fee methodology is reasonable and a viable option is its continued use. However, the current method favors companies that incur actual inspection time in excess of estimated standard inspections that also have relatively low pipeline miles. Conversely, the current method does not favor companies with high pipeline miles that involve inspection effort less than estimated.

Our recommendations are provided in the final section of this report and an illustration of its application is provided in Appendix A. We recommend this methodology for the following reasons:

- **Ease of Implementation.** The recommended methodology is straightforward and uses existing, readily available information.
- **Eliminates Estimates.** Using actual historical effort from the time accumulation system and actual costs from the accounting system eliminates the need for any estimates and, therefore, more closely reflects the actual costs incurred for each inspected company.
- **Fees are closely linked to actual time.** Stakeholders generally agreed that effort expended by the Pipeline Safety staff should be the primary driver of fees paid by the company causing the effort. The recommended method should be perceived as the most equitable method as it reduces the differences between actual directly assigned time and the fees paid by individual companies.

We believe a fee methodology that allocates a majority of costs based on average hours incurred, specifically assigned to companies, with a lesser amount of cost assigned by pipeline miles is the most fair and equitable method. We also believe that Federal grant funding, which is designated for use in either gas pipeline safety programs or hazardous liquid pipeline safety programs should be used to offset direct inspection costs for those respective programs. Our recommendation is based on actual average costs and actual average time and effort and, therefore, assigns costs to individual companies based upon their respective use of pipeline safety personnel time and effort. We also believe that the transition to a new pipeline safety fee methodology should be managed by use of a “stop loss” mechanism whereby no company incurs an increase in fees of more than 20%.

## Background and Scope of Work

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### Project Background

The Washington Utilities and Transportation Commission pipeline safety program began inspecting natural gas systems operating within the state of Washington in

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1955. Intrastate hazardous liquid pipelines were added to WUTC's authority in 1996. In 2000, the Legislature approved the Pipeline Safety Act (HB 2420) directing the program to seek Federal approval to include inspections of all interstate pipelines. In 2001, the Legislature adopted the Pipeline Safety Funding Bill (SB 5182). In 2003, after working closely with the Federal Office of Pipeline Safety (OPS) for two years, the pipeline safety program became the lead inspector for all interstate pipeline inspections and incidents within the state of Washington.

There are various sections of current Washington State Law that have an impact on fee rate methodologies. However, the core requirements are contained in RCW 80.24.060 for Gas pipelines and mirrored in RCW 81.24.090 for Hazardous Liquid pipelines. RCW 80.24.060 states, in part:

*(2) The commission shall by rule establish the methodology it will use to set the appropriate fee for each entity subject to this section. The methodology shall provide for an equitable distribution of program costs among all entities subject to the fee. The fee methodology shall provide for:*

*(a) Direct assignment of average costs associated with annual standard inspections, including the average number of inspection days per year. In establishing these directly assignable costs, the commission shall consider the requirements and guidelines of the federal government, state safety standards, and good engineering practice[s]; and*

*(b) A uniform and equitable means of estimating and allocating costs of other duties relating to inspecting pipelines for safety that are not directly assignable, including but not limited to design review and construction inspections, specialized inspections, incident investigations, geographic mapping system design and maintenance, and administrative support.*

In addition, both 80.24 and 81.24 contain the following language regarding a regulatory incentive program:

*(8) After establishing the fee methodology by rule as required in subsection (2) of this section, the commission shall create a regulatory incentive program for pipeline safety programs in collaboration with the citizens committee on pipeline safety. The regulatory incentive program created by the commission shall not shift costs among companies paying pipeline safety fees and shall not decrease revenue to pipeline safety programs. The regulatory incentive program shall not be implemented until after the review conducted according to RCW 81.88.150.*

While a legal determination of the practical effects of this language on setting pipeline safety fees is outside the scope of this project, we have provided a discussion of various cost accounting interpretations of this language in the methodology section of this report.

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### **Scope of Project**

In designing this project, the WUTC considered its needs for information in rulemaking in establishing revised fee rules, establishing a regulatory incentive program and for developing a Federal Indirect cost rate proposal.

The WUTC requested the following specific activities for this project:

- Review WUTC held information, including statutory authority with respect to setting pipeline fees, requirements of current rules, and available data related to workload and staff time by activity to understand the limits of current statutory authority and availability of needed fee-related data.
- Participate in a meeting with WUTC, pipeline operators and stakeholders. The purpose of the meeting will be to describe how the WUTC plans to undertake the fee review, and get operator feedback on the current fee methodology and their ideas on improving the methodology.
- Identify the various categories of program costs that may need to be allocated using a distinct methodology.
- Review WUTC cost accounting and describe alternative methods for allocating the various categories of program costs and the advantages and disadvantages of each.
- Participate in a second meeting with WUTC, pipeline operators and stakeholders to review proposed fee methodology including providing a description of the alternatives considered and advantages and disadvantages of each.

### **Summary of Project Activities**

In addition to background information, we obtained actual historical information from the time accumulation system and the accounting system for the fiscal years ended June 30, 2003 and 2004. Utilizing this information, we performed a series of analyses of the existing information, including costs and time by industry type and time by individual company. We assessed current methodology in relation to underlying time and cost data and in relation to the Federal Pipeline Safety awards.

Using the data obtained and the results of our analysis, we developed several different options that could be considered by the WUTC in its rulemaking deliberations. These options were presented to and discussed with WUTC management and staff. Based on their input, these options were refined, applied to specific company situations, accumulated in a stakeholder meeting preparation package, and provided to stakeholders.

A stakeholders meeting was held on November 16, 2004, in which the options were explained and stakeholder input was obtained. This meeting was followed by written questions posed to stakeholders by WUTC. The WUTC received 6 written responses to the questions.

Considering stakeholder input, our assessment of the current method and the relative advantages and disadvantages of the various options developed, we completed our

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recommendation for a new fee methodology. The recommendation was included in a draft of this report that was provided to WUTC management and staff for their consideration. The draft report was also available to stakeholders for their use in preparing for a stakeholders' meeting conducted on January 11, 2005.

Working with WUTC management and staff, we determined whether the draft report and recommendation was sufficient for their use in the rule-making process. This report is the result of these project activities.

In addition to the fee methodology work, we also considered options that may be available to implement a regulatory incentive program. Options were developed and presented to WUTC. Since our opinion on a regulatory incentive program was not requested, we did not provide any recommendation.

Finally, we were requested to assist in the development of a Federal indirect cost rate for the WUTC as a whole. We obtained cost accounting data from the WUTC accounting system and reviewed the current allocation method to current Federal regulations and guidance. We provided suggestions for changes to the current method for compliance with those standards and developed an alternative single rate-simple method for WUTC consideration.

## Fee and Indirect Cost Methodologies

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### Cost Accounting Interpretations of Statute

The statute, previously discussed, states that the average annual standard inspection costs are to be directly assigned to companies. The statute also states that costs that are not directly assignable *"including but not limited to design review and construction inspections, specialized inspections, incident investigations, geographic mapping system design and maintenance, and administrative support."* shall use *"A uniform and equitable means of estimating and allocating costs."* If the term "directly assignable," is interpreted as the ability to track costs incurred in the past to particular companies, this distinction seems not to make sense, from a cost accounting perspective.

While GIS systems design and maintenance and administrative support are not likely to be tracked by individual companies, the other inspection types (construction, specialized and incident investigation) are tracked, specifically, by company. Because these activities are directly assigned to companies in the WUTC time and effort tracking system, they are, by cost accounting definitions, "directly assignable". If, however, the term "directly assignable" is interpreted to mean capable of being known and assigned to a particular company prior to actually being incurred, then the distinction in the statute makes sense.

This difference between the cost accounting interpretation and the statutory meaning of the term "direct assignment" is important to understand in using the reported results and recommendations from this project. The *"uniform and equitable means of estimating and allocating"* that we propose for allocating those costs that the statute defines as "not directly assignable" includes tracking historic costs to particular

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companies. It also happens to be the same method that we propose for assigning the average annual standard inspection costs. Because it is a *“uniform and equitable means of allocating costs”*, the proposal is likely in conformity with the statute even though the statute specifically states that these costs are not directly assignable. In this project, we have used average actual costs, regardless of whether they are for standard or special inspections, to determine the possible fees based on direct costs versus indirect costs.

**Description of Cost Accumulation Systems**

In order to fully understand the various fee methodologies, it is important to understand the data upon which the fee options are established. The WUTC uses two separate systems for tracking time and costs. A separate timekeeping system tracks various activities by nature and industry type. This data is accumulated in an Access database system. Costs are accumulated by using the statewide accounting and financial reporting system and by an internal system.

Costs for the pipeline safety program are tracked in the accounting system by each of four “industry” categories as follows:

- 014 Gas Interstate
- 015 Gas Intrastate
- 224 Hazardous Liquid Intrastate
- 225 Hazardous Liquid Interstate

The cost data includes direct costs charged (or coded) directly to each of the industry categories. In addition to directly coded costs, agency overhead costs are accumulated in specific pools and allocated to industry categories using time as the base for allocation. We obtained the program cost data for 2003 and 2004 for use in creating the estimated fees for some of the method examples.

**The Effort Versus Pipeline Miles Issue**

The core issue in this project is whether actual time involved in specific company or industry activities is a better measure of effort than pipeline miles. There is disagreement about this core issue in that some believe that pipeline miles are highly correlated to the effort involved in managing a pipeline safety program, while others do not. Since 60% of current fees are allocated by pipeline miles, its use as an allocation base has a significant impact on individual company fees.

A good way to illustrate this concept is to compare percentages based on time and the current fees. The WUTC timekeeping system allows for coding time to a company and to an industry type, even though the time is not assigned to a specific company. The first chart shows the difference in percentages between the current fee methodology and time-based methodology by industry types. Please note that rounding affects certain totals presented in the following charts.

<b>Percentage difference between industry time assignment and fees</b>	<b>GAS</b>	<b>HAZARDOUS LIQUID</b>	<b>TOTAL</b>
<b>INTERSTATE</b>	-13.75%	4.98%	-8.78%
<b>INTRASTATE</b>	-7.35%	16.12%	8.78%
<b>TOTAL</b>	-21.10%	21.10%	0.00%

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The result of this analysis indicates that the companies in the interstate gas group pay more in fees, as a whole, than the underlying time coded to that industry group (regardless of whether the time was directly assigned to a company or not). The opposite is true of the intrastate hazardous liquid group. This analysis also shows that there is a significant advantage difference between gas and hazardous liquid and a lesser advantage difference between inter and intra state. This result is consistent with the rate per hour analysis discussed above.

These differences, however, are lessened when the current fees are compared to only time that has been directly assigned to companies as follows:

<b>Percentage difference between company direct time assignment and fees</b>	<b>GAS</b>	<b>HAZARDOUS LIQUID</b>	<b>TOTAL</b>
<b>INTERSTATE</b>	-8.62%	0.59%	-8.03%
<b>INTRASTATE</b>	1.88%	6.16%	8.03%
<b>TOTAL</b>	-6.75%	6.75%	0.00%

Depending on whether one believes that fees should be based on time or on pipeline miles, the result of this analysis shows an inherent fairness (pipeline miles) or unfairness (time).

Our objective in presenting various fee methodology options is to highlight this issue by showing examples of fees based solely on hours and combinations of hours and pipeline miles.

### **Federal Awards**

The Pipeline Safety Program receives two Federal awards each year, one for Gas Pipeline Safety program purposes and the other for the Hazardous Liquid Pipeline Safety Program. While nationally, the gas related awards are much larger than the hazardous liquid related awards, the gas awards are split among almost all 50 states and the hazardous liquid awards are split among 16 states. As a result, the Washington State gas award (\$439,309 or 58%) is slightly more than the hazardous liquid award (\$320,558 or 42%). This relationship is much different than the splits among pipeline miles, which are 780.38 miles (3.6%) for Hazardous Liquids and 21,006.59 miles (96.4%) for Gas systems. These awards are significant to the fee methodology because they fund approximately 40% of total program costs.

The current fee methodology splits both program costs and the Federal awards based on past relative time incurred by intrastate and interstate companies (currently 37% to interstate companies and 63% to intrastate companies). The current method mitigates the effect of the large differences in awards versus pipeline miles.

However, we favor a methodology that keeps the fundamental purpose of the Federal awards intact. That is, to use gas program awards to subsidize gas safety program costs and hazardous liquid awards to subsidize hazardous liquid safety program costs. This opinion, if implemented in a revised fee methodology, may increase perceived



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inequities, as the Federal award for the hazardous liquid safety program may fund substantially all related program costs, depending upon how the WUTC accumulates costs by program.

### **Fee Methodologies Considered**

Based on the analysis of the current fee methodology above, we considered methodologies that might reduce the variance of effort versus fees. Fee methodologies were, at first, considered separately from the underlying cost allocation methodologies that could be employed. Several different types of fee methodologies were considered to explore the alternatives and their possible effects on individual companies.

The methods considered in this project are described in Appendix C. A general description of the method, the estimated effect on combined fees paid by the four industry categories and some discussion of the advantages, disadvantages and other factors to consider are provided for each method. We also provided worksheets for each method that show how the method might be applied to specific companies, to the WUTC and stakeholders, separately from this summary report.

Some general comments about the data and methods are useful.

- All methods apply calculations to the net cost to be recovered during fiscal year 2005 of \$1,234,424. This means, except where noted, the Federal grants are credited from total costs without allocating them to specific industry categories.
- Included in the 2005 total of \$1,234,424, are two direct bills that reduce the 2005 cost pool that is applied to all other companies. For each methodology, an approximate effect on the four industry groups is provided. For purposes of comparisons, we provide comparisons to current 2005 fees and "normalized" 2005 fees, that eliminate the direct billings, to account for the extraordinary effect of the two direct billings that occurred in 2005.
- Because the statute, cited previously, uses the term "average costs", all methods use actual data for both 2003 and 2004 and average the data. The statute also uses the term "directly assignable." If the WUTC has directly assigned effort by the timekeeping system or directly assigned costs in the accounting system, for this exercise, we consider that time and cost data to be directly assignable.

The methodologies considered are briefly described in Appendix C and are listed below. Many of the options build upon data developed in previous options.

**Option 1** is the current fees paid by companies. It is used as a comparison for all other options in Appendix B. Option 1 is a valid fee-setting method and is considered along with all other options. In Appendix B, we also provide comparisons to "normalized" 2005 fees by eliminating the two direct billings in the calculation. Therefore, in Appendix B, we present two versions of Option 1. We were provided the calculation of the current 2005 fees from the WUTC. As such, the process of "normalizing" the 2005 fees for an alternative comparison was straightforward. By eliminating the deductions for the two direct billings, that effectively reduced the amount to be paid by other companies, the pool of costs were increased and we applied the same methodology to that revised pool as is used in the current fee methodology.

**Option 2** uses the timekeeping system data for direct hourly charges to each company during 2003 and 2004. Option 2 averages the two years of directly assigned hours to

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develop a percentage for each company that can be applied to the 2005 net recoverable costs.

**Option 3** uses this same time reporting information but segregates them into four major direct inspection types. The total 2003 and 2004 hours are averaged for each type of direct inspection time. The relative percentages for each of these four types are used to create a cost pool only for that inspection activity. Each cost pool is then allocated to individual companies based on their actual inspection time coded to that inspection activity type. **Option 3b** segregates total costs into a direct inspection pool and an indirect pool based upon total direct versus indirect time. The direct portion is allocated based on the actual time incurred for each company while the indirect portion is allocated by miles of pipeline.

**Options 4, 5 & 6** are similar in their application. These methods use actual accounting costs for each industry category. Actual costs for 2003 and 2004 are averaged. **Option 4** uses four distinct pools for each of the four industry categories. **Option 5** combines the four pools into a Gas pool and a Hazardous Liquid pool. **Option 6** combines the industry pools into interstate and intrastate pools. In these three options, all of the **(a)** variations use direct time as the base for allocation. All of the **(b)** options use direct time for only a portion of the costs and use miles of pipeline for the remainder.

**Option 7** averages the results of all of the previous options. **Option 7(a)** corrects for the over-weighting caused by **Options 4, 5 and 6** being similar. **Option 7(b)** uses the results of **Option 7(a)** but employs a stop-loss or a maximum increase cap of 20%. This method shows how a limit to individual company impacts might be employed.

Finally, **Option 8** introduces the concept of a base regulatory fee. In this method a base fee of \$10,000 is established and is used to offset the indirect costs that are allocated by miles of pipeline.

### Stakeholder Input

This project was designed to incorporate the stakeholders' perspective of the current fee methodology as well as potential fee methodologies considered. The options briefly discussed above, were provided to stakeholders along with a calculation of how the change in fee methodology might impact their respective company's fees. A meeting was held to discuss the various options and elicit feedback on the relative fairness or equity of each option. After that meeting a series of questions were developed by WUTC staff to elicit written feedback on a variety of issues involved in the fee methodology deliberations.

While no consensus of view points were expressed by shareholders, there were a few themes that emerged from the stakeholders' meeting that we report below and should help guide the final rate methodology decision.

- There was some general agreement that effort expended by the Pipeline Safety staff should be the primary driver of fees paid by the company causing the effort. This concept held true for general rate setting methodology, as well as the concept of "direct assignment" of special and unusual effort, such as

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incident investigations. There was some desire to adjust an hours-driven fee methodology if it included a direct billing mechanism for unusual events.

- Most stakeholders indicated that pipeline miles could be used as a fair way to allocate general program costs that were not directly assignable to a specific company. However, stakeholders varied in their opinion as to what proportion of total program costs should be allocated via a pipeline miles method. Some stakeholders believe that pipeline miles is a good surrogate for the driver of pipeline safety costs as they believe that more pipeline miles involved in a system will require more effort to inspect. Other stakeholders believe that a company could operate a “good” system with many miles that would take less inspection effort than a “bad” system with relatively few miles of pipeline.
- The concept of a flat regulatory fee exposed in option 8 described previously met resistance from the smaller systems as it would shift costs from the larger systems to the smaller systems and, depending on the amount of the base fee, could dramatically increase the annual fee paid by those smaller systems.
- Certain stakeholders expressed a concern about the method (option 4b) that accumulates costs by industry group then allocates those costs by a combination of hours and pipeline miles. The current fee method distributes a majority of the total costs by pipeline miles. Because large systems such as the local distribution companies are included in the total mileage count under the current method and would be excluded from the other industry specific totals (e.g. Intrastate Hazardous Liquid) a “small” operator when viewed in relation to the overall mileage would become much more significant if costs and miles by industry were considered.
- Certain interstate operators believe they should receive some credit for fees paid to the Federal Office of Pipeline Safety (OPS) since the state receives grant funds from OPS that are applied (in general) to all companies, both intra and interstate companies under the current fee methodology. Other stakeholders believe the OPS fees do not overlap fees paid for the state program.

In addition to the feedback provided during this meeting by stakeholders, a series of questions were provided subsequent to the meeting for written responses. As of the due date for responses, only six responses were received. These responses were not significantly different from the feedback obtained from the stakeholder meeting in that the perspective of fairness changes depending upon the nature of the company (i.e., large vs. small, interstate versus intrastate, gas versus hazardous liquid).

- Regarding the level of satisfaction with the current fee method, two support the current method, one would support the current method if changed and three did not support the current method.
- Most respondents favored recognizing actual time incurred as the main focus for allocating costs, especially when discussing incident investigations. When the discussion was focused on which “normal” costs should be directly

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assigned to companies the responses were divided between only standard inspections, all inspections and as many costs as possible.

- Responses were split as to whether costs identified (assigned) to an industry group should be allocated to members of that group. However, when asked how to split the Federal grant offset, two responses favored the current method (intra-interstate split based on time data), two supported a credit based on gas and hazardous liquid components and one suggested a 50% credit for Federal fees paid.
- Regarding the preference as to how non-directly assignable costs or activities should be allocated, two favored direct time, one favored miles, one could support either and one respondent suggested that these costs be divided equally among all companies.
- Two respondents supported a base regulatory fee to cover some portion of costs while three were opposed. Most supported a cap on annual increases.

The only clear conclusion from the initial stakeholders' meeting and the subsequent written responses is that no method will achieve uniform acceptance from all stakeholders. However, we believe that there is an opportunity to implement a fee methodology that reduces some perceived inequity. This can be accomplished by retaining the existing process of allocating a portion based on time and the remainder based on mileage, but increasing the proportion based on direct effort and reducing the portion allocation by pipeline miles.

## RECOMMENDATION

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### Summary

We believe a fee methodology that allocates a majority of costs based on average hours incurred, specifically assigned to companies, with a lesser amount of cost assigned by pipeline miles is the most fair and equitable method. We also believe that Federal grant funding, which is designated for use in either gas pipeline safety programs or hazardous liquid pipeline safety programs should be used to offset direct inspection costs for those respective programs. Our recommendation is based on actual average costs and actual average time and effort and, therefore, assigns costs to individual companies based upon their respective use of pipeline safety personnel time and effort. We also believe that the transition to a new pipeline safety fee methodology should be managed by use of a "stop loss" mechanism whereby no company incurs an annual increase in fees of more than 20%.

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In considering our recommendation we performed the same analysis of equity in relation to effort caused by industry groups and individual companies, as we previously provided in our analysis of the current fee methodology. The results without using a stop-loss mechanism and the results that utilizes a stop-loss mechanism are shown in the following two charts. Each chart compares the difference in percentages between directly assigned time and the recommended fees.

<b>Percentage difference between company direct time and recommendation (before Stop Loss)</b>	<b>GAS</b>	<b>HAZARDOUS LIQUID</b>	<b>TOTAL</b>
<b>INTERSTATE</b>	4.34%	-2.71%	1.63%
<b>INTRASTATE</b>	-3.46%	1.84%	-1.63%
<b>TOTAL</b>	0.88%	-0.88%	0.00%

Negative percentages indicate a disadvantage when comparing recommended fees to the average directly assigned time. Once again, rounding affects certain totals.

Either method reduces differences between time and fees from the current method in the totals. However, certain quadrants (i.e., intrastate gas and interstate hazardous liquids) flip from advantaged, in the current fee method to disadvantaged in the recommendation. While not using a stop-loss is more equitable in terms of inter-industry-type subsidies than using the stop-loss mechanism, these ratios obscure the impact on individual companies. As such, our recommendation includes a stop-loss provision to protect the interests of individual companies.

<b>Percentage difference between company direct time and recommendation (after Stop Loss)</b>	<b>GAS</b>	<b>HAZARDOUS LIQUID</b>	<b>TOTAL</b>
<b>INTERSTATE</b>	-1.87%	-1.52%	-3.38%
<b>INTRASTATE</b>	-2.39%	5.77%	3.38%
<b>TOTAL</b>	-4.26%	4.26%	0.00%

We recommend this methodology for the following reasons:

- **Ease of Implementation.** The recommended methodology is straightforward and uses existing, readily available information. The accumulation of average hours and the stop-loss mechanism adds some complexity as compared to the current method. The average hour calculation requires pivot tables to be run from Excel downloads from the timekeeping Access database system for each year. However, this process is not very time-consuming. We expect that the extra hours from the added complexity are much less than the hours needed to estimate the standard inspection day rate under the current method.
- **Eliminates Estimates.** The current method must estimate the standard inspection day rate and estimates the number of inspection days for each company. By their nature these estimating processes are imprecise. Using actual historical effort from the time accumulation system and actual costs from the accounting system eliminates the need for any estimates and,

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therefore, more closely reflects the actual costs incurred for each inspected company.

- **Fees are closely linked to actual time.** Stakeholders generally agreed that effort expended by the Pipeline Safety staff should be the primary driver of fees paid by the company causing the effort. The recommended method should be perceived as the most equitable method as it reduces the differences between actual directly assigned time and the fees paid by individual companies.

### Pipeline Safety Fee Methodology Recommendation

Based upon our analysis of the nature of pipeline safety program costs, Federal awards, existing statute, sound cost accounting principles, ease of implementation, stakeholder input and resulting judgments of fairness and equity, we recommend the following methodology be adopted to allocate program costs to fee-payers.

#### Step 1: Cost Segregation

Total pipeline safety program costs are segregated into three cost categories and averaged for two to five years (currently three years of data are available but two years are used for the example). These three categories are defined as 1) Gas Pipeline Safety Program Operation, 2) Hazardous Liquid Pipeline Safety Program Operation and 3) Pipeline Safety Program and WUTC Management and Support. In the remaining steps we refer to these components of costs as 1) Direct Program Costs and 2) Support Costs. The Direct Gas Program Costs will include direct costs charged to industry codes 014 and 015. The Direct Hazardous Liquid Program Costs will include direct costs charged to industry codes 024 and 025. The costs in these categories will be accumulated before (exclude) any allocations from either various "overhead" accounts or code 540 (pipeline safety general). Support costs will include any "overhead" items that are allocated based upon hours incurred in the various WUTC programs and will include code 540 (pipeline safety general) or by using a general indirect cost rate. The result of this procedure will be to determine a percentage of costs, on average, between Direct Gas and Hazardous Liquid Program Costs and Support Costs (e.g. 42% Direct Gas Program Costs, 28% Direct Hazardous Liquid Program Costs and 30% Support Costs)

#### Step 2: Direct Program and Support Cost Pool Determination

Using the results of step 1 above, the current year appropriation is divided between Direct Gas and Hazardous Liquid Program Costs and Support Costs categories. Direct Program Costs are allocated to individual companies based upon the average hours incurred (directly assigned) for a two to five year period (currently three years of data are available and two years are used for the example) in relation to the average of all time directly assigned (using a single pool). If a "direct bill" mechanism has been employed during any of the averaging periods, the hours related to such a "direct bill" should be eliminated from the average direct hours calculation to avoid a double counting issue.

#### Step 3: Apply Federal Award and Direct Billing Credits to Direct Cost Pools

The Federal gas pipeline safety award will reduce the cost pool for gas companies determined under step 2 above. Similarly, the Federal hazardous liquid grant will

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reduce the cost pool for hazardous liquid companies determined under step 2 above. If a direct billing mechanism has been used, the amount is used to reduce the applicable cost pool.

**Step 4: Allocate Net Direct Cost Pool Totals to Individual Companies**

The net cost (Direct Program Costs less applicable Federal grant) for each of the gas and hazardous liquid pools are allocated to individual companies based upon their relative percentage of incurred hours to the total of incurred hours for their industry (gas or hazardous liquid).

**Step 5: Allocate Support Costs by Pipeline Miles**

Total Support Costs determined in Step 2 above are allocated to individual companies based on pipeline miles using a one-pool method.

**Step 6: Combine Direct Program Costs and Support Cost Calculations**

Individual company allocations of Direct Program Costs based upon average actual time incurred, applied to the net cost pool for either gas or hazardous liquid is added to the Support Cost allocation based upon pipeline miles. The total of these two cost calculations represents the preliminary fee.

**Step 7: Apply a 20% "Stop Loss" Mechanism**

Once Step 6 is completed, increases in individual company fees are calculated and reviewed. To the extent that any one company incurs a preliminary fee increase of more than 20%, their excess over 20% is reallocated to companies with preliminary decreases or increases of less than 20%.

The application of this methodology is illustrated in Appendix A. The example illustration reduces the average directly assigned hours by the average of the directly billed time. For example, Williams was direct billed for 2600 hours that was used to offset program costs allocated to other companies in the 2004 fee methodology. The effect of this direct bill was to reduce both Williams and the total average hours by 1300 hours (2600 divided by two years). When comparing current fees to recommended fees, the direct bill for Williams of \$219,050 was added back to both the current fees and the recommendation. This same procedure was used for the Olympic direct bill. Also a difference between the recommendation and the options presented during the project was to eliminate the hours from Whidbey Naval Air Station and Evergreen Aluminum as they are not subject to fees, even though hours were incurred during 2003 and 2004.

**Other Aspects of the Recommendation**

Certain stakeholders supported a base fee to allocate non-directly assignable costs. While in theory and concept, we support such a mechanism for a portion of the costs, the application of the concept became unwieldy. Dividing support costs equally by the number of companies would cause certain companies to have a quadrupled fee impact. The application of a 20% stop-loss mechanism essentially eliminates the redistribution of these costs from larger pipeline systems to smaller systems. As such a base regulatory fee was not included in our recommended methodology.

**Washington Utilities and Transportation Commission**  
**Summary of Project Results and Recommendations**

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The treatment of incident investigations has been addressed, in effect, by the use of actual average directly assigned hours in our recommended fee methodology. However, a few comments are noteworthy. A few stakeholder comments suggested that while they agree with the core concept of companies that cause time and effort should directly pay for that effort, the direct charge for incidents should be the amount in excess of a planned amount for incidents. This means that all companies would share in the cost of anticipated incidents.

Based upon discussions with Pipeline Safety Program staff, they do not build capacity, specifically, for incident investigations. In other words, if no incident occurred during a given year, the staff would be able to conduct more special inspections and follow-up activities, which would result in fees based on actual directly assigned hours. As such, we believe that all significant incident investigations be subject to a "direct bill" mechanism that would prospectively account for unusual situations (experienced during the past year and, therefore, included in the average historical hours) in the next year's fees, and that all other companies should benefit from the reduction of such specific allocation by reduction to the costs involved in the specific pool of costs (i.e., gas versus hazardous liquid). To be clear, we believe that any incident that requires onsite staff inspection time (excluding minor telephone incident inquiries or other similar time spent) should be considered for a direct bill mechanism. Whether time is included as an "incident" or is merely directly assigned time should make little difference in the recommended methodology. We recommend that all incident investigation time that meets the "significant" criterion be subject to a direct bill mechanism. Such time should be excluded from the average direct time calculation, and the amount should be deducted from the specific pools (i.e., gas versus hazardous liquid) upon which the fees are calculated.